

Washington State's Housing Market: A Supply/Demand Assessment

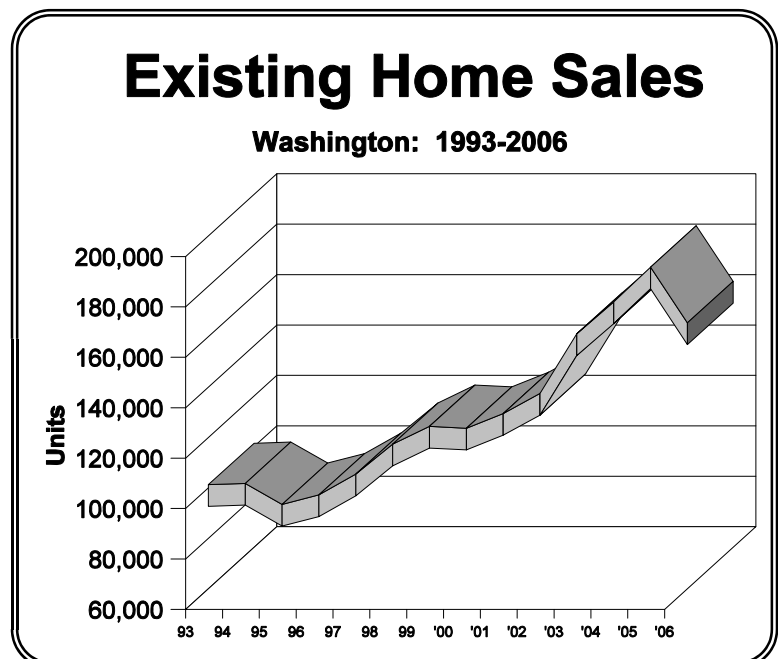
Fourth Quarter 2006

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After setting records for existing home sales every year since 2001, the home resale market retreated significantly in terms of unit sales volume in 2006. The 161,240 single-family homes sold last year were 12.0 percent fewer than in 2005 (and actually somewhat below 2004 sales), but still represented a very active market by the standards of the last decade. Annual statistics on resale housing markets prepared by the National Association of REALTORS® indicated a decline in home sales activity of 8.4 percent nationwide and 16.6 percent throughout the West. Factors contributing to the softer housing market include somewhat higher mortgage interest rates (although the increases in rates were less significant than originally feared), and the recent surge in home prices in most areas which combined with the higher rates to make homes much less affordable to families. In addition, news stories about declining home prices in some markets caused investors, who were estimated to represent about 40 percent of home sales in 2005, to move from their role as purchasers to sellers. Like the resale market, the new construction market moved to a lower level of activity as builders reported many cancelled sales and cut back on speculative construction. While reports of declining home prices have prevailed in the media, annual prices in virtually all Washington counties in 2006 were above 2005 medians, and most were at least 10 percent higher (the statewide median rose 12.6 percent compared to 2005). Despite some market stabilization, the Washington housing market was among the best in the nation last year.

Home Resales

Statistics collected from multiple listing services and from organizations which monitor deed recordings in areas where multiple listing coverage is less complete, indicate that sales of single-family homes (excluding most new construction) declined 16.6 percent from the fourth quarter of 2005, recording 36,480 units sold between October 1 and December 31. These statistics show a typical seasonal decline in actual sales compared to the third quarter. This was the fourth consecutive quarter of year-to-year sales declines and the largest decline in quarterly sales from one year to the next since early 1995. While the



Washington market is not marching in lockstep with the “national” housing market, it is subject to many of the same drivers and clearly cooling from its former overheated state.

Only two of the 39 Washington counties reported more home sales in late 2006 than a year earlier (Whitman and Yakima), with Jefferson and Wahkiakum counties reporting flat sales. Declines ranged from 0.8 percent in Thurston County to 40.5 percent in Chelan and Douglas counties. Among the micropolitan areas, the markets ranged from Whitman’s strength (up 18.9 percent) to a decline of 21.6 percent in Lewis County.

Note: This report uses the definitions of metropolitan and micropolitan areas by the Office of Management and Budget. Briefly, metropolitan areas are larger communities with at least 50,000 people in the urban core. Micropolitan areas are smaller cities, with 10,000-50,000 people in the urban core. Currently, Washington has 17 metropolitan counties in 13 metropolitan areas (or divisions) and nine micropolitan areas.

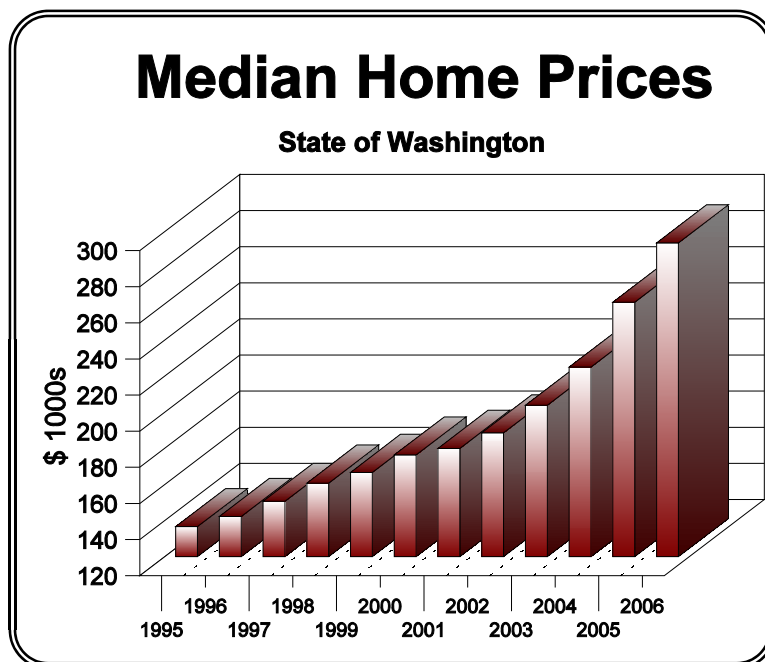
Housing Construction

Construction activity, as measured by building permits, declined 32.9 percent compared to the fourth quarter of 2005, with both single-family and apartment construction registering significant declines. A total of 7,797 housing units were authorized for construction during the quarter, with 5,337 of those units for single-family homes. Far more complete data on 2006 building permits will be included in the next issue of **Washington State’s Housing Market**, since the Census Bureau typically releases final annual permit numbers in April.

At the local level, total housing construction increased compared to late 2005 in four counties, decreased in 24, and was unchanged in two where the Census Bureau releases monthly statistics. The 5-county Central Puget Sound region represented nearly 70 percent of the state’s building permits in late 2006.

Home Prices

The median selling price for a resale home in the state of Washington during the fourth quarter of 2006 was \$301,400. This is \$25,700 (9.3%) higher than the fourth quarter median in 2005. Median prices during the fourth quarter are usually a little lower than the third quarter, but in 2006 (as in 2004 and 2005) a slight increase was observed. However, the \$500 increase in 2006 was much less than between the third and fourth quarters in 2005. The median price for full year 2006 was \$293,800, an increase of 12.6 percent compared to 2005. The median price in Washington was \$71,800 above the national median and \$57,400 below the median in the West. The national median increased 1.4 percent during 2006, while in the West the increase was 3.2 percent, further demonstrating the comparative strength of the Washington market in



2006.

Local area prices in the fourth quarter ranged from a low of \$87,900 in Adams County to a high of \$620,000 in San Juan County. Only Adams County reported a median price less than \$100,000, while 17 counties now have medians of at least \$200,000. Of those, San Juan, King, Snohomish, Jefferson and Island counties have medians in excess of \$300,000.

In the last quarter of 2005 20 counties recorded increases in median prices of at least 20 percent compared to the fourth quarter of 2004. By contrast, in 2006 only five counties had such extreme increases in medians. Six counties even had lower median prices than a year earlier. Among metropolitan counties, price changes ranged from a 4.1 percent decline in Benton/Franklin counties to a 24.1 percent jump in Asotin County. Among the micropolitan markets, the range was from Kittitas

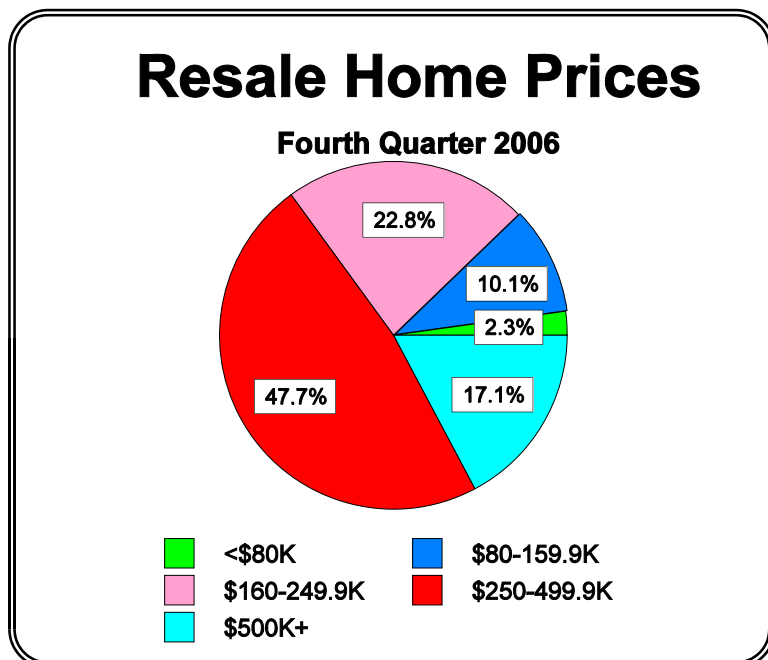
County's (Ellensburg) 20.9 percent increase to Whitman's (Pullman) 6.0 percent slide.

Measures of central tendency, like median prices (half the homes sold were more expensive, half less) which use a single number to represent a distribution of home prices, tend to confuse some consumers into believing there is nothing less expensive than the median in the marketplace. While there were significant numbers of homes which sold for prices well below the statewide median, the largest concentration of less costly housing is outside a reasonable commuting distance from major population centers. However, even in urban areas, lower cost housing is often available, especially if the buyer is willing to invest some hard physical labor improving the home. In fact,

while "only" 2.3 percent of the single-family homes sold during the fourth quarter were priced no higher than \$80,000, this represents about 840 homes. Clearly, affordable ownership housing is available and being purchased throughout Washington state. It should be stressed that these statistics represent only resale, single-family homes. Condominium apartments and manufactured homes represent other affordable ownership housing options.

Housing Affordability

A central feature of these reports is always the statistics on housing affordability. Following the model developed in 1982 by the National Association of REALTORS®, the Washington Center for Real Estate Research calculates a housing affordability index for all buyers and for first-time buyers for each county in the state where price data is available. These affordability calculations depend on statistics from a variety of sources. The effective mortgage rate on loans closed during the quarter (national average, 6.54 percent) is used in this calculation. While the average downpayment on home purchases is 25 percent, the most frequently encountered downpayment is 20 percent. Accordingly, that



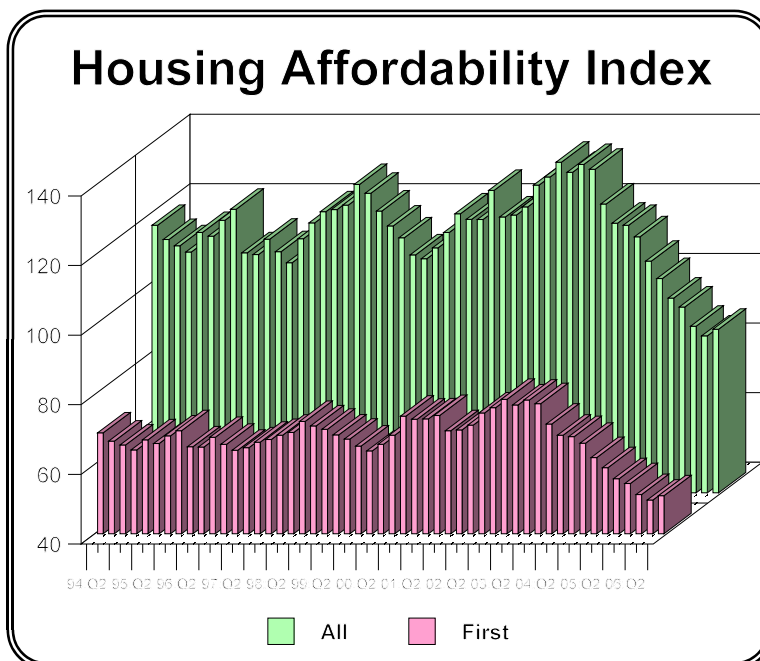
percentage is used in the calculation of the all-buyer index. A 30-year term is assumed for paying off the loan.

Income is the other key component of affordability analysis. WCRER obtains county-level data on family and household incomes from a consulting firm. In economic statistics, a family is two or more people related by blood, marriage or adoption who share a housing unit. Single adults with children or other dependent relatives (e.g. an aging aunt) are families. Household income includes all families as well as persons living alone or unrelated individuals sharing a housing unit (roommates). Since the vast majority of home purchases (approximately 85%) are made by families, family income is used in the calculation of the all-buyer affordability index.

The Housing Affordability Index for Washington State in the fourth quarter of 2006 stood at 87.0, meaning that a median income family had 13.0 percent less income than the bare minimum required to qualify for a mortgage on the median price home. This represents a sharply diminished affordability condition than the index of 96.0 which prevailed a year ago, or the index value of 134.4 from three years ago. Affordability increased modestly in the fourth quarter compared to the third quarter as the median price was basically unchanged and mortgage rates eased a bit while incomes continued to advance. Locally, housing affordability indexes ranged from a low of 39.3 in San Juan County to a high of 193.9 in Adams County. Among metropolitan areas, affordability indices ranged from a high of 180.9 in Benton County to a low of 69.6 in King County. Among the smaller urban areas the range is from a low of 79.3 in Island County to a high of 136.7 in Grant County.

While statistically sound, the all-buyer index does not adequately describe the difficulty households have purchasing their first home and beginning the process of developing equity. Most first-time buyers are younger, less established in their careers and without the financial means for a large downpayment. Accordingly, a separate index which adjusts the assumptions has been developed, again patterned on the national methodology. It assumes a 10 percent down payment, even though many lower down payment programs are widely available. Less expensive homes are purchased by first time buyers, typically at prices 85 percent of the area median price. Because the assumed downpayment is less than 20

percent of the purchase price, mortgage insurance must be carried, effectively increasing the mortgage rate by one-quarter point. Since most higher-income households have already purchased homes, the income measures for renters are lower. Household rather than family incomes are used because many more first-time buyers live alone. To account for the departure of the higher income group from the pool, the first-time buyer income is estimated to be 70 percent of the median household income in the area. Using these assumptions produces a statewide first-time buyers index for the fourth quarter of 50.9. Again, this reflect a slight improvement in affordability compared to the preceding quarter, but



is less affordable than a year ago

The first-time buyer index exceeded 100 (meaning the typical first-time buyer could realistically be able to afford the typical starter home in that community) in only two counties, Adams and Benton. Unfortunately, this is down sharply from 19 affordable counties three short years ago. Only one additional county (Columbia) had an index above 90, indicating a small increase in the down payment or purchasing a home slightly below the assumed price would result in an affordable purchase. At the other extreme, first-time buyer indexes were below 60 in 15 counties (five more than a year ago), indicating the affordability crisis is still severe. In King County the would-be first time homebuyer had less than 40 percent of the income required to purchase the typical "starter" home, and in San Juan County the value was less than 25! If households cannot afford to purchase their first home, the homeownership rate will begin to decline. Since high levels of homeownership have been demonstrated to be consistent with many desirable features of communities, the affordability crisis is truly a community problem.

Affordable Housing Availability

The range of choices for several communities around the state is described for four household categories. In all cases it is assumed a household is willing to spend 25% of gross income on principal and interest payments and that overall debt levels are average. Household category groups are defined by their income and their ability to make a downpayment. The groups studied are:

- \$ 25,000 income, 5% downpayment
- \$ 50,000 income, 10% downpayment
- \$ 75,000 income, 20% downpayment
- \$125,000 income, 35% downpayment

It will be assumed that these buyers will be able to find mortgages for their purchases at an interest rate of 6.5% (approximately the same as prevailing rates during the quarter).

Affordable Home Purchase Prices for Selected Income/Asset Groups

Income	Affordable Housing Expense (P&I)	Mortgage Amount	Downpayment	Home Purchase Price
\$ 25,000	\$ 521	\$ 82,401	\$ 4,337	\$ 86,738
\$ 50,000	\$ 1,042	\$164,803	\$ 18,311	\$ 183,114
\$ 75,000	\$ 1,563	\$247,204	\$ 61,802	\$ 309,005
\$125,000	\$ 2,604	\$412,007	\$ 221,850	\$ 633,857

This table clearly illustrates how income growth coupled with ownership of homes with increasing values moves a household up the ownership housing ladder. When reviewing these statistics it is important to remember that the median family income in the state during the quarter was \$63,928, and ranged from a low of \$40,338 in Okanogan County to a high of \$74,618 in King County. Household incomes were predictably lower, ranging from \$33,060 in Whitman County, with its large student population, to \$61,383 in Snohomish County. The statewide median household income was

\$52,415. This means the lower two price ranges are most relevant for residents of the state.

The next question is how much opportunity there will be in Washington to find a home which can be afforded under the assumptions? Using data reported by multiple listing systems around the state, the proportion of homes available for sale at the end of the quarter with prices at or below each threshold price indicates the degree of choice available to each group, and how difficult it will be to find suitable ownership housing.

One additional note is needed. The homes used in this calculation are those available for sale as of the end of December, when inventories are typically at their seasonal low (fewer people attempt to sell their homes over the holidays). Since these MLS systems typically handle only about 80 percent of the market, and some areas were not able to report details about their listing inventory in the format WCRER uses, housing choices may differ somewhat from these estimates. Since these are offering prices, actual sales may occur below or above these prices, depending on local market conditions, and motivations of the buyers and sellers. Nevertheless, they are reflective of housing market access in these communities.

Percentage of Homes on Market Below Specified Price – December, 2006

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	6.9%	46.3%	72.3%	95.1%
Benton/Franklin	7.5%	44.5%	80.6%	97.6%
Chelan/Douglas	3.3%	15.5%	36.3%	78.3%
Clallam	2.2%	6.9%	29.9%	83.8%
Clark	1.1%	2.2%	20.2%	74.9%
Cowlitz	3.4%	28.3%	62.4%	89.9%
Ferry/Pend Oreille/Stevens	6.7%	37.7%	59.6%	92.4%
Grant	8.6%	40.3%	64.1%	93.4%
Grays Harbor	3.6%	30.2%	61.1%	94.2%
Island	0.2%	2.1%	19.4%	75.2%
Jefferson	0.4%	5.4%	19.0%	72.0%
King	0.0%	0.2%	2.3%	46.7%
Kitsap	0.1%	2.7%	20.9%	71.9%
Kittitas	0.3%	5.1%	31.3%	81.3%
Lewis	3.3%	18.7%	49.9%	93.3%
Mason	0.9%	16.4%	50.4%	89.6%
Pacific	1.5%	16.6%	56.6%	85.4%
Pierce	0.0%	2.5%	21.7%	82.5%

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County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
San Juan	0.0%	1.2%	2.4%	22.0%
Skagit	1.3%	5.8%	27.0%	76.3%
Spokane	0.9%	18.4%	49.4%	89.0%
Snohomish	0.2%	0.8%	5.2%	64.8%
Thurston	0.0%	2.8%	28.0%	86.7%
Walla Walla	3.9%	28.5%	65.5%	91.0%
Whatcom	1.7%	5.4%	21.7%	82.0%
Whitman	9.7%	24.2%	68.5%	99.2%
Yakima	15.8%	52.0%	76.7%	97.6%
Statewide	1.7%	10.3%	28.5%	76.1%

These statistics make it clear that in most parts of the state first-time home buyers still face extremely limited choices in the housing market, while trade-up buyers have a wide assortment of homes from which to choose in all communities. Significantly, virtually no homes in King County have asking prices below \$80,000, while over half have an asking price in excess of \$500,000. Virtually no (less than 1 percent) lower cost housing is available in Island, Jefferson, Kitsap, Kittitas, Pierce, San Juan, Snohomish or Thurston counties.

It should be pointed out that the \$25,000 income level is now somewhat below the income used to calculate the statewide first-time buyer affordability index. This means if those households were actively in the home purchase market, they would be competing for the lowest-priced 1.7% of the available statewide inventory. These lower-cost homes, if they are in reasonably good condition in stable neighborhoods, should sell quickly, while higher priced homes may wait awhile for the right buyer, since there are many units available and relatively few qualified buyers for those homes. Communities in Eastern Washington generally offer far greater choices of lower-cost homes.

Available Inventory

Much of the media attention in recent months has focused on the apparent surge of homes on the market, frequently described as record high levels of homes available for sale. While that may be true on some high-profile national markets in California, Florida, the mid-Atlantic and even Las Vegas, the situation in Washington seems different. Listings available at year end were higher than any other recent year, but since listing tend to be lower at year-end than at mid-year, it is unlikely this is a record inventory.

As illustrated in the table which follows, the number of listings available for sale at the end of the fourth quarter was at the highest level this decade in ten of the 23 counties or county groups for which WCRER has consistent listings data for most of the years. The first three years of the decade had higher levels of listing inventory in 12 counties. All third quarters with higher inventory levels are shaded in the table.

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Listings Available for Sale – Year-end

County	2000	2001	2002	2003	2004	2005	2006	%ch 2005-06
Asotin	488	510	406	349	308	268	350	30.6%
Benton/Franklin	738	779	1,071	1,254	1,412	1,435	1,436	0.1%
Chelan/Douglas	538	514	446	417	315	243	336	38.3%
Clark	n/a	1,042	2,071	1,657	1,502	2,090	3,064	46.6%
Cowlitz	472	454	580	467	337	346	505	46.0%
Ferry/Pend Oreille/Stevens	298	360	328	299	238	221	223	0.9%
Grant	361	349	382	311	324	317	290	-8.5%
Grays Harbor	518	574	577	473	334	443	504	13.8%
Island	633	620	597	513	426	498	661	32.7%
Jefferson	n/a	n/a	n/a	n/a	192	204	279	36.8%
King	4,942	6,233	6,820	5,742	4,405	4,101	5,137	25.3%
Kitsap	1,287	1,166	1,138	868	681	845	1,352	60.0%
Kittitas	n/a	n/a	195	206	204	180	294	63.3%
Lewis	538	492	404	344	349	308	551	78.9%
Mason	582	560	460	370	304	361	530	46.8%
Pierce	3,503	3,809	3,701	2,843	2,521	3,010	4,597	52.7%
San Juan	n/a	n/a	161	182	162	149	164	10.1%
Skagit	659	706	673	594	437	488	705	44.5%
Snohomish	2,876	3,038	3,370	2,957	2,330	2,289	3,044	33.0%
Spokane	3,057	3,230	3,683	1,486	1,553	1,573	2,350	49.4%
Thurston	933	874	759	731	631	938	1,441	53.6%
Whatcom	1,456	1,343	994	n/a	569	988	1,289	30.5%
Whitman	188	122	197	104	112	98	124	26.5%
Yakima	911	845	878	749	829	774	1,253	61.9%
State	24,978	27,620	29,891	22,916	20,475	22,167	30,479	37.5%

WCRER also computes estimates of the month's supply of housing by price range. A month's supply statistic measures how long it would take to sell all the homes currently available for sale if no new listings were added. The actual MLS sales during full-year 2006 are compared to the end-of-year listing inventory, with the result multiplied by 12 to yield a month's supply. There was only a 3.6

month's supply of homes on the market at year-end, compared to 2.4 months at the end of 2005. This represents a fairly tight listing inventory, suggesting that increases in prices can still be expected in the short term if interest rates remain low and no surge of new listings reaches the market.

Historically, balanced markets are characterized by a five to seven month's supply of homes on the market. Most markets in the state, in communities large and small, can be described as approaching a balanced inventory, with the remainder still under supplied. No market has excess inventory as of year-end 2006. The most severe shortage of listings was in King County, with Snohomish county close behind, each recording inventory levels of less than three months. The longest month's supply was in Jefferson and Lewis counties, with a listing inventory capable of sustaining sales at current rates for 6.6 months -- a balanced market on the verge of over supply.

The market is tightest for homes selling for mid-range prices. The longer month's supply for homes in the under \$80,000 category may be due to units offered for sale which need substantial work – they are few in number but cannot attract the typical buyer. Unlike previous reports, all markets had a least one sale above \$500,000 in 2006, but if there were several listings at that level, some local high-priced supplies could wait many months to sell, despite the active market. Homes priced above \$500,000 are in excess supply in most areas, but the Seattle metropolitan area, where most of the expensive homes are located, would be characterized as having a balanced supply or perhaps still a shortage of expensive homes to sell. It is common for homes at this price level to take longer to sell since they tend to be unique, and buyers in those price ranges have the ability to be more selective.

**Month's Supply of Housing by Price Range
December, 2006
Selected Washington Counties**

County	Under \$80,000	\$80,000 - \$159,999	\$160,000 - \$249,999	\$250,000 - \$499,999	\$500,000 and above	Total Market
Asotin	3.3	3.7	5.1	8.5	204.0	4.8
Benton/Franklin	5.3	4.8	6.3	7.0	13.2	5.7
Chelan/Douglas	2.1	1.7	1.6	4.8	15.6	3.1
Clark	3.5	2.3	2.7	6.2	15.8	5.5
Cowlitz	1.1	2.5	3.3	9.8	21.9	4.6
Ferry/Pend Oreille/Stevens	1.9	3.8	4.8	10.3	20.4	5.1
Grant	2.1	2.2	3.4	9.6	28.5	3.5
Grays Harbor	1.2	3.6	6.2	10.8	24.9	5.4
Island	2.0	2.7	3.7	5.6	8.3	5.5
Jefferson	2.4	4.8	4.6	6.4	10.5	6.6
King	0.0	1.5	0.9	1.7	3.3	2.2
Kitsap	0.7	2.0	2.3	4.4	8.4	4.1
Kittitas	1.7	2.6	3.5	6.3	20.2	5.4
Lewis	3.3	2.8	5.9	14.3	49.3	6.6

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County	Under \$80,000	\$80,000 - \$159,999	\$160,000 - \$249,999	\$250,000 - \$499,999	\$500,000 and above	Total Market
Mason	0.6	2.9	4.6	8.5	11.6	5.1
Pierce	0.2	2.0	2.1	4.2	8.7	3.7
Skagit	3.6	3.0	2.7	5.3	10.9	4.7
Snohomish	1.9	1.5	0.9	2.3	5.9	2.7
Spokane	0.8	1.7	2.8	5.8	11.5	3.3
Thurston	0.0	2.2	2.1	4.6	9.6	3.6
Walla Walla	1.8	3.7	5.1	6.0	18.0	4.8
Whatcom	5.7	3.8	2.9	6.1	8.5	5.3
Whitman	3.8	2.3	4.0	5.2	2.0	3.8
Yakima	6.4	4.9	5.8	10.8	16.5	6.2
Statewide	2.6	3.0	2.8	3.6	5.5	3.6